CADWALADER

From Russia with Sanctions – Cayman Introduces General Licence for Certain Funds

October 14, 2022 | Issue No. 196

By **Derek Stenson**
Partner | Conyers

By **Michael O'Connor**
Partner | Harneys

By **Sarah Farquhar**
Associate | Conyers

Russia's invasion of Ukraine has demonstrated again how interconnected the political and financial worlds have become. For those of us in the private equity and finance worlds, it has also given rise to associated challenges posed by the Russia-related financial sanctions that have followed. In the fund finance market, these issues have arisen both for sponsors (who are now faced with issues around freezing the assets of sanctioned investors without being able to remove them) and lenders (some of whom have been faced with credit parties to their facilities who now have sanctioned investors in their LP roster).

Unfortunately for us, there is no easy way to address these issues as the war, and sanctions issues, continue to rumble on.

In response to the sanctions and the associated problems that have arisen for investment funds that have sanctioned investors, the Governor of the Cayman Islands last week issued a General Licence (GL/2022/0001) in respect of "Designated Persons – Redemption/Withdrawal of investment, basic needs, routine holding and maintenance and payment of legal fees" (the General Licence).

Spoiler Alert: While most industry participants hoped that the General Licence would provide welcome solutions to issues with sanctioned minority investors in Cayman funds, this is unfortunately not the case for the reasons set out below.

What is the current position?

In short, where a fund has a sanctioned investor (which has been identified by the fund/fund manager itself or by its administrator as part of a periodic check of investors, which is more often the case) it must: (i) freeze the assets and funds of the sanctioned investor; (ii) report the issue to the Cayman Islands Financial Reporting Authority; and (iii) not take any action that could be considered to be "dealing" with the assets of the sanctioned investor, nor make any funds or economic resources available to them. As the definition of "deals with" is very broad, it has led to a position whereby there are few, if any, actions a fund can take in respect of a sanctioned investor once it has frozen the assets – in particular, it cannot (without obtaining a licence, at least) redeem or involuntarily withdraw such an investor from the fund and place its assets in a blocked account or attempt to "sidepocket" the investor without potentially being seen to "deal" with the assets.

What permissions has the General Licence introduced and why does it not help with minority investors that are sanctioned?

The General Licence provides that a “Relevant Investment Fund” may redeem, withdraw or otherwise deal in an investment interest of a person that *is not* a designated person or owned/controlled by a designated person (a designated person being a sanctioned person).

A “Relevant Investment Fund” is defined as being an investment fund whose assets are frozen due to the investment fund being owned or controlled (*e.g.*, 50%+) directly or indirectly by a designated person. We understand that this segment of the market is so small as to be negligible and covers only a handful of funds.

Accordingly, the General Licence is not very helpful to the most frequent issue (minority holdings in a fund by a sanctioned person and the ability to remove that investor from a fund). Even if the definition did cover funds with minority investors, the permissions in the General Licence would not be of obvious use to most funds, as it provides for the redemption/withdrawal of non-sanctioned investors. This, of course, is the opposite of what industry participants had hoped for – being that the fund would now be able to redeem out the problem/sanctioned investor and freeze their assets, allowing the fund to continue on with the non-sanctioned investors.

It’s also important to note that any action to withdraw/redeem an investor is only permitted provided the actions are also permitted by the fund’s constitutional and contractual documents. The licence does not override the contractual position of the fund’s LPA.

Any fund wishing to rely upon the General Licence also needs to be mindful of other applicable sanctions regimes that it may be subject to.

Are there any additional general licences anticipated?

At present, the existing General Licence expires in April 2023 (unless revoked/suspended earlier by the Governor), and so any action that relevant funds wish to take must be ahead of this timeline. It isn’t yet clear if further general licences are to be expected and, if so, whether they would advance the position and allow for the redemptions/withdrawal and subsequent freezing of sanctioned investors from Cayman Islands funds.